

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of)

Price Cap Performance Review)
for Local Exchange Carriers)

CC Docket No. 94-1

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY**REPLY COMMENTS OF HYPERION TELECOMMUNICATIONS, INC.**

Hyperion Telecommunications, Inc. ("Hyperion"), by its attorneys, hereby submits its reply comments in the above-referenced proceeding. Hyperion believes the Commission must proceed with caution in deciding whether, and how much, pricing flexibility should be granted to local exchange carriers ("LECs") under the price cap plan. Actual competition must precede streamlined regulation if consumers are to enjoy the benefits of competition in the telecommunications market.

I. INTRODUCTION

In their comments, the LECs go to great lengths to demonstrate that they are subject to significant competition and should be relieved of the burdens of price cap regulation. As usual, however, these claims ignore the undeniable fact that the LECs are (and for the foreseeable future will continue to be) the sole providers of local exchange service in virtually every market in the United States. The recent vacation of the Commission's co-location requirements^{1/} combined with legal barriers to entry in the local exchange market ensure that the prospect of robust facilities-based competition is likely to remain remote.

It is vital that the Commission not prematurely provide LECs excessive pricing flexibility. The current price cap rules already provide significant

^{1/} See Bell Atlantic Telephone Co. v. F.C.C., Case No. 92-1619 (D.C. Cir. June 10, 1994).

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pricing flexibility and the Commission's Expanded Interconnection decisions for special access^{2/} and switched transport^{3/} provide further flexibility in the form of density zone pricing and volume and term discounts. The comments cite LEC discounts in excess of 70 percent for certain services under the existing rules.^{4/} The Commission must be wary of LEC claims that even more flexibility is necessary to respond to competition. Until a LEC can demonstrate that competition exists in a given geographic market, the Commission should not relieve LECs from access charge regulation.

II. COMPETITION DOES NOT EXIST UNTIL COMPETITORS PROVIDE SUBSTITUTABLE SERVICES IN A GEOGRAPHIC MARKET

In Transition Issue 1, the Commission requests comment on the appropriate test for determining if competition exists, how competition should be measured and what effect competition should have on LECs under the price cap rules. Hyperion has stated previously that the Commission should not permit

2/ Expanded Interconnection with Local Telephone Company Facilities, Report and Order and Notice of Proposed Rulemaking, 7 FCC Rcd 7369 (1992). The pricing flexibility granted to LECs in the Special Access Order is uncertain in light of the court's decision in Bell Atlantic. Under the proposal advocated by Teleport Communications Group in its Petition for Declaratory Ruling, however, LECs would have the option to obtain the flexibility granted in the Special Access Order by voluntarily offering physical co-location.

3/ See Expanded Interconnection with Local Telephone Company Facilities (Transport Phase I), Second Report and Order and Third Notice of Proposed Rulemaking, 8 FCC Rcd 7374 (1993). Hyperion and others have challenged the Commission's Switched Transport Order because it grants pricing flexibility to LECs before competition exists in a market. See Petition for Reconsideration of Hyperion Telecommunications at 4 (filed October 18, 1993) ("Hyperion Reconsideration Petition").

4/ See Comments of Intermedia Communications of Florida at 3.

LECs to have pricing flexibility without first determining that a relevant market is competitive.^{5/} A number of factors must be present for the Commission to make a finding that competition exists in a particular geographic market and the comments demonstrate that such competition does not exist today.^{6/}

First, competitors must be authorized to provide the full range of services provided by the incumbent LEC.^{7/} Until a new entrant lawfully can provide customers the same services as the incumbent it cannot be said that a market is competitive. Although the LEC comments point to limited evidence of competition in certain segments of the access market, the fact that LECs provide interstate access services on the same ubiquitous integrated network as all their other services suggests that the Commission should not measure competition in the access market in a vacuum.^{8/}

At the present time, only a handful of states permit competition for switched local services and no CAP has authority to provide competitive

5/ "Hyperion believes that this flexibility to reduce rates should not be granted until the LEC can demonstrate that effective or meaningful competition exists in the market in which it proposes to offer density zone pricing or volume and term discounts." Hyperion Reconsideration Petition at 4.

6/ Hyperion believes the Commission should grant pricing flexibility only for specific geographic markets where competition exists, rather than for a carrier's entire service area. Hyperion has previously suggested that pricing flexibility for LECs be tied to "competitive zones" based on the density zone pricing plans established pursuant to the Expanded Interconnection orders. See Hyperion Reconsideration Petition at 9.

7/ Legal authority to provide competitive local services must include interconnection, unbundling and numbering policies that eliminate a LEC's ability to impose unreasonable costs on its competitors. Without appropriate policies on these issues, it will not be economically feasible for a CAP to offer a local service in competition with the LEC.

8/ See Comments of Teleport at 23; Comments of MFS at 38.

residential services. Consequently, in virtually every state CAPs are at a competitive disadvantage because they cannot provide the full range of switched services offered by the incumbent LEC. Comments of MFS at 44. Moreover, it will not be profitable for the CAP to make the initial investment in a switch until it can maximize the use of switching facilities by providing local exchange service. Comments of Time Warner at 10. Therefore, in states where CAPs are prohibited from providing switched local services they cannot provide the ubiquitous access that interexchange carriers ("IXCs") demand.^{9/}

Even if legal barriers to entry are removed, a CAP may be hesitant to enter the market for switched services if the incumbent LEC has the ability to reduce its rates selectively in response to the introduction of competition. Under the current price cap rules, LECs have ample ability to compete through zone density pricing, volume and term discounts and bundling of switched and dedicated services.^{10/} LECs also are able to take advantage of their ubiquitous networks by offering discounts based on capacity commitments without requiring the customer to commit to particular facilities or locations. Because no CAP (or

^{9/} This limitation on the ability of CAPs to compete is critical. One measure of competition used by the Commission in its regulation of AT&T is supply elasticity. The LEC comments make much of the excess capacity they claim exists on CAP fiber networks. Unlike the interexchange market, however, supply elasticity in the access market must factor in the tremendous cost of extending existing facilities to new customers, even in cities where there is an established CAP presence.

^{10/} The Commission has recognized that streamlined regulation is not appropriate for a service that can be bundled with another service that is not subject to effective competition. For example, until 800 number portability was introduced the Commission did not streamline regulation of AT&T's 800 services and it prohibited AT&T from bundling 800 services with other services. See Competition in the Interstate Interexchange Marketplace, Report and Order, 6 FCC Rcd 5880 (1991) ("Competition Order"), Memorandum Opinion and Order on Reconsideration, 7 FCC Rcd 2677 (1992) ("Competition Reconsideration Order").

other non-LEC competitor) has the ubiquity to compete with such offerings, Hyperion previously has proposed limiting the scope of these "portability" offerings to competitive zones. See Hyperion Reconsideration Petition at 9. This would ensure that pricing flexibility is limited to geographic areas where competition exists and not surreptitiously expanded into noncompetitive markets.

An additional factor that is essential to a showing that competition exists is that a competitor has facilities in place that actually are used to provide competitive service. Potential competition is not a sufficient control on LEC prices to justify streamlined regulation. USTA, for example, cites cable operators as a major source of competition for LECs. Comments of USTA at 30-31. This position cannot be reconciled with the fact that no cable operator may lawfully provide basic local exchange service to residential customers.^{11/} Furthermore, at least one LEC has acknowledged that cable systems are "poorly suited to provide switched, two-way telephone services to individual customers."^{12/} Accordingly, the presence of a cable system (or other potential competitors) in a LEC's service area provides no evidence of competition until the system actually is used to provide a full range of competitive telecommunications services.

^{11/} A subsidiary of Southwestern Bell recently became one of the first cable operator to request authority to provide commercial residential telecommunications service over a cable system. Approval of Southwestern Bell's application to provide local exchange service in Montgomery County, Maryland is expected to take over a year and the application states that it will be five years before ubiquitous service is available.

^{12/} Bell Atlantic's Request for an Expedited Waiver Relating to Out of Region Interexchange Services and Satellite Programming Transport, Affidavit of Brian D. Oliver at 4 (filed January 20, 1994).

III. LEC PRICING FLEXIBILITY SHOULD CORRESPOND TO THE LEVEL OF COMPETITION IN A GEOGRAPHIC MARKET

Once the minimum criteria for competition have been satisfied, the appropriate level of regulation (or deregulation) for the incumbent LEC should depend on the actual level of competition in a market. Hyperion previously has suggested that the relative market share of competitors should be a key factor in making this determination.^{13/} Market share is an important measure of competition in a market dominated by a single provider because it provides confirmation that all barriers to entry have been eliminated and that customers have been presented with a real choice of service providers. Once a certain level of customer acceptance is reached (as evidenced by market share), some degree of streamlining may be appropriate. Full deregulation of LEC pricing, on the other hand, would not be appropriate until a much higher threshold is reached.

The Commission has followed a similar policy with great success in its regulation of AT&T. The Commission, relying on market share as evidence of demand elasticity, did not streamline regulation of AT&T's business services until AT&T's market share for those services was approximately 50 percent. See Competition Order, 6 FCC Rcd at 5889. Similarly, the Commission refused to streamline regulation of AT&T's residential and small business services based on its finding that "AT&T still holds by far the largest market share" for those services.^{14/}

^{13/} See Hyperion Reconsideration Petition at 9.

^{14/} Price Cap Performance Review For AT&T, Report, 8 FCC Rcd 5156 (1993) ("1993 Performance Review"). At the time, AT&T's share of the relevant markets was approximately 60 percent.

USTA rejects the use of market share as a measure of competition. Rather, USTA proposes a measure of market power that focuses on whether a customer's demand is "addressable" by a competitor.^{15/} Under this standard, a LEC would have "freedom to respond to competition as it emerges." USTA advanced this proposal last year and the oppositions filed by Hyperion and others demonstrated why the plan proposed by USTA would encourage anticompetitive behavior by the LECs.

Nothing has changed since last year to alter the conclusion that USTA's proposal will hinder the development of competition. Until effective competition is established in a market, the "freedom" of a dominant carrier to respond selectively to competitive entry has significant anticompetitive implications.^{16/} This is particularly true when a competitor's low market share is the product of a legal regime that favors the LEC based solely on its status as a monopoly provider of local exchange services. Furthermore, use of a trigger mechanism based on addressability in the access market completely ignores the competitive advantage LECs possess by virtue of the lack of "addressability" in other LEC markets.^{17/}

^{15/} USTA has proposed a system under which LECs would be granted additional pricing flexibility for access services as soon as a "substitutable" service was offered in a service area. LEC access charges would be deregulated if 25 percent of customers in the area had a competing service available and 25 percent actively sought to use non-LEC access services. Comments of USTA at 62-66.

^{16/} "[W]hen AT&T offers to reduce its rates only to match the rate reductions of its competitors . . . AT&T's offering will have serious potential anticompetitive consequences." AT&T Communications (Tariff F.C.C. Nos. 1, 2 and 9), 6 FCC Rcd 5675 (1991).

^{17/} This is comparable to the Commission's decision not to streamline regulation of
(continued...)

IV. THE PRESENT LEVEL OF COMPETITION FOR ACCESS SERVICES DOES NOT WARRANT EQUAL TREATMENT OF LECS AND CAPS

In Baseline Issue 9, the Commission requests comment on whether any of the price cap rules should be revised to equalize treatment of LECs and CAPs and whether LEC and CAP access charges should be treated equally under the AT&T price cap rules. Just last year the Commission found that AT&T's Basket 1 services use LEC switched access almost exclusively and that equal treatment was unnecessary. See 1993 Performance Review, 8 FCC Rcd at 5168-69. Since that time the Commission has adopted rules requiring expanded interconnection for switched transport and CAPs in some states have been granted authority to provide switched services to small business customers. The Commission questions whether these changes require a change in the rules.

It is unlikely that these minor regulatory advances will have any significant effect on AT&T's decision to purchase access from a LEC or its ability to use CAP services. In light of the Bell Atlantic decision it seems unlikely that expanded interconnection will in fact promote switched access competition. At the state level, CAPs still are not permitted to provide local service to residential customers in any market and to business customers in most markets. Furthermore, any incentive AT&T might have to shift traffic from LEC to CAP services under the current rules must be balanced by the fact that CAP facilities

17/ (...continued)

AT&T's 800 services and to prohibit bundling of 800 services with other services until 800 number portability had been implemented. See Competition Reconsideration Order, 7 FCC Rcd at 2679.

only are able to service a fraction of AT&T's customers.^{18/} Consequently, there is every reason to believe that AT&T will continue to purchase the bulk of its switched access from the LECs and there is no justification for changing the current rules.

**V. INFRASTRUCTURE DEVELOPMENT SHOULD BE
ENCOURAGED THROUGH COMPETITION, NOT PRICE CAP
INCENTIVES**

In Baseline Issue 1, the Commission requests comment on whether the price cap plan should be revised to support the development of a national information infrastructure. Hyperion agrees with those comments suggesting that the best way to encourage infrastructure investment is by encouraging competition. Comments of Teleport at 6; Comments of Ad Hoc Users at 11. These comments demonstrate that the primary factor motivating infrastructure investment by LECs is the presence of competitors. Furthermore, the evidence does not demonstrate that the current rules provide any disincentive for LEC investment or that financial incentives will encourage additional investment.^{19/} LECs should not be provided with special incentives to provide facilities and services that CAPs, cable operators and other non-LECs are equally capable of providing. If the Commission believes incentives are necessary to assure universal service or to provide particular services, such incentives should be available to all telecommunications providers on a nondiscriminatory basis.

^{18/} "CAPs do not provide an option for the vast majority of customers, nor will they in the foreseeable future." Comments of AT&T at 9-10.

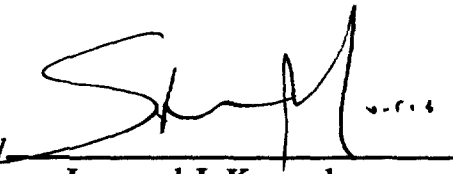
^{19/} The fact that LECs invest a smaller percentage of their revenues in capital expense than their potential competitors is a function of their market power, not a flaw in the price cap rules.

VI. CONCLUSION

Hyperion recognizes that regulation of LECs must reflect continuing technological and competitive developments. Nevertheless, the Commission must be certain that it will not harm consumers by providing LECs excessive flexibility before a competitive market for all LEC services is allowed to develop. Until all legal, technical and economic barriers to competition have been removed, there is no reason to equalize treatment of LECs and CAPs.

Respectfully submitted,

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